

Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 TRSE-00 XMB-04 COME-00 FRB-01
AID-05 CIAE-00 EB-08 INR-10 NSAE-00 ICA-20
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R 271635Z JUN 78
FM AMEMBASSY MADRID
TO SECSTATE WASHDC 5110
INFO AMEMBASSY PARIS
AMEMBASSY BRUSSELS
AMEMBASSY LISBON

UNCLAS SECTION 01 OF 04 MADRID 07231

USOECD; USEEC

PASS TREASURY, EXIM, COMMERCE, FRB

E.O. 11652: N/A
TAGS: EFIN, SP
SUBJECT: SPANISH FOREIGN DEBT

REF: MADRID A-115 OF JULY 22, 1977

1. SUMMARY: TOTAL MEDIUM AND LONG TERM FOREIGN DEBT, BOTH PUBLIC AND PRIVATE, STOOD AT \$13.857 BILLION AT THE END OF 1977. THIS IS AN INCREASE OF 28.7 PERCENT OVER YEAR END 1976. (SEE CHART AT END OF TELEGRAM.) THE DEBT SERVICE RATIO FOR 1977 WAS 13 PERCENT.

- THE FORECAST FOR YEAR END 1978 IS APPROXIMATELY \$15.3 BILLION, AN INCREASE OF 10.4 PERCENT. DEBT IS EXPECTED TO RISE TO AROUND \$16 TO \$16.5 BILLION DURING 1979. IF THE BALANCE OF PAYMENTS CURRENT ACCOUNT HOLDS
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TO A REASONABLE DEFICIT LEVEL, AS HAS BEEN THE CASE OVER THE LAST 10 MONTHS, THE RATE OF GROWTH OF SPAIN'S FOREIGN DEBT WILL CONTINUE TO DECLINE.

- IN MANY ASPECTS SPAIN IS STILL A DEVELOPING COUNTRY, AND MODERATE CURRENT ACCOUNT DEFICITS, WHICH REPRESENT A NET TRANSFER OF REAL RESOURCES INTO THE COUNTRY, CAN BE

A POSITIVE FORCE FOR ECONOMIC GROWTH. THIS DEPENDS OF COURSE ON THE CONTINUED WILLINGNESS OF FOREIGN CREDITORS TO FINANCE THE DEFICITS. GIVEN THE SIZE OF THE SPANISH ECONOMY, AND THE RECENT SURGE IN EXPORTS, DEBT SERVICING LOADS OF ABOUT THE PRESENT LEVEL SHOULD PRESENT NO PROBLEMS. SPAIN'S CREDIT IS GOOD AND SHOULD REMAIN SO FOR THE FORESEEABLE FUTURE. END SUMMARY.

2. BACKGROUND:

- DURING ITS YEARS OF RAPID ECONOMIC GROWTH, THE SPANISH ECONOMY BECAME INCREASINGLY DEPENDENT ON IMPORTS OF ENERGY, FEED GRAINS, AND HIGH COST CAPITAL GOODS. BEGINNING IN 1974 WHEN THE COST OF OIL IMPORTS INCREASED DRAMATICALLY, BALANCE OF PAYMENTS DEFICITS BEGAN TO PILE UP, AND FOREIGN INDEBTEDNESS GREW RAPIDLY TO COVER THEM. (TOTAL DEBT WENT FROM APPROXIMATELY \$5.5 BILLION IN 1974 TO \$8 BILLION IN 1975, AND \$10.8 BILLION IN 1976.)

- IN THE FIRST HALF OF 1977 SPAIN BORROWED HEAVILY TO FUND A CURRENT ACCOUNT DEFICIT THAT WAS THREATENING TO REACH \$5 BILLION BY YEAR END. WITH RAMPANT INFLATION (OVER 30 PERCENT), AN OVERVALUED CURRENCY AND GENERAL LACK OF ATTENTION TO FUNDAMENTAL ECONOMIC PROBLEMS, THE COUNTRY WAS OBVIOUSLY IN TROUBLE. THE ELECTIONS OF JUNE 1977 SET THE COUNTRY ON A STABLE POLITICAL COURSE AND ALLOWED THE GOVERNMENT TO DRAW UP AND BEGIN TO UNCLASSIFIED

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IMPLEMENT A FAR-REACHING STABILIZATION AND STRUCTURAL REFORM PROGRAM, EMBODIED IN THE MONCLOA PACTS OF OCTOBER 1977.

3. CURRENT SITUATION:

- VERY REAL PROGRESS HAS BEEN MADE IN REDUCING THE CURRENT ACCOUNT DEFICIT. BY YEAR END 1977 THE DEFICIT WAS DOWN TO \$2.5 BILLION. IN THE FIRST QUARTER OF 1978 IT WAS \$137 MILLION AND THE OFFICIAL FORECAST FOR ALL OF 1978 IS AROUND \$1 BILLION OR PERHAPS SOMEWHAT LESS.

- INFLATION IS WITHIN THE TARGET RANGE OF 17 PERCENT FOR 1978 AND RESERVES ARE AT AN ALL TIME HIGH (\$7.3 BILLION AT THE END OF MAY).

- THE STRUCTURAL REFORM EFFORT, AIMED AT PUSHING SPAIN TOWARDS A MORE FREE MARKET ECONOMY IS TAKING HOLD. THE MONEY MARKET IS ALLOCATING RESOURCES MORE ON THE LINES OF CREDIT WORTHINESS; AND LESS ON OLD-LINE SPECIAL RELATIONSHIPS AND FORCED INVESTMENT COEFFICIENTS. THE BEGINNINGS OF ESTABLISHING A VIABLE SECONDARY MARKET HAVE BEEN MADE

AND FOREIGN BANKS ARE BEING PERMITTED TO OPEN BRANCHES.
A COMPREHENSIVE FISCAL REFORM PACKAGE IS MOVING THROUGH
PARLIAMENT AND THE GOVERNMENT IS TAKING SOME LONG NEEDED
STEPS TO STRENGTHEN ITS BUDGETARY FORMULATION AND CONTROL
SYSTEM.

4. THE ECONOMY REMAINS FLAT, HOWEVER, AND SORELY TROUBLED
BY RISING UNEMPLOYMENT. IT WILL PROBABLY REMAIN THIS WAY
FOR AT LEAST THE NEXT YEAR OR TWO BEFORE APPRECIABLE
GROWTH IN REAL TERMS RESUMES. IF THE AUSTERITY AND
REFORM PROGRAMS ARE ADHERED TO, AND MOST SIGNS POINT TO
THE GOVERNMENT'S DETERMINATION TO DO SO, THEN A MORE
BALANCED, LESS INFLATIONARY ECONOMY SHOULD RESULT.

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FM AMEMBASSY MADRID

TO SECSTATE WASHDC 5111

INFO AMEMBASSY PARIS

AMEMBASSY BRUSSELS

AMEMBASSY LISBON

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USOECB; USEEC

PASS TREASURY, EXIM, COMMERCE, FRB

MASSIVE CURRENT ACCOUNT DEFICITS REQUIRING HEAVY AND
CONSTANTLY INCREASING FOREIGN BORROWINGS SHOULD NO LONGER
BE A MAJOR PROBLEM FOR THE COUNTRY, OR A SOURCE OF
CONCERN FOR SPAIN'S CREDITORS.

5. FUTURE BORROWING NEEDS:

- ORDINARY COMMERCIAL AND PUBLIC ENTERPRISE BORROWING
WILL OF COURSE CONTINUE TO GROW FOR THE NEXT SEVERAL
YEARS AS THE ECONOMY BEGINS TO PICK UP. EVEN WITH
STRUCTURAL REFORM AND CONTROL OF INFLATION, IT WILL BE

SEVERAL YEARS BEFORE THE SPANISH MONEY MARKET IS BROAD OR DEEP ENOUGH TO FUND A LARGE VOLUME OF LONG TERM CAPITAL REQUIREMENTS. EQUITY AS A SOURCE OF FINANCING IS LIKEWISE NOT THE WHOLE ANSWER AS MARKETABLE INSTRUMENTS ARE NOT YET POPULAR ENOUGH IN SPAIN TO PROVIDE THE VOLUME OF CAPITAL NEEDED. ALSO, THE STOCK MARKET HAS

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BEEN STAGNANT FOR QUITE SOME TIME. PRIVATE AND PUBLIC ENTERPRISE FOREIGN BORROWING IS THUS EXPECTED TO CONTINUE TO INCREASE FOR THE NEXT SEVERAL YEARS; BUT MAINLY TO IMPORT OR INVEST IN PRODUCTIVE ASSETS WHICH THUS REPRESENTS A NET TRANSFER OF REAL RESOURCES INTO SPAIN. THE AMOUNT OF FUNDS NEEDED DEPENDS ON HOW SOON GROWTH RESUMES, AND HOW STRONG IT IS.

6. 1977 COMPARED TO 1976:

- TOTAL FOREIGN DEBT, BOTH MEDIUM AND LONG TERM, INCREASED 28.7 PERCENT FROM YEAR END 1976 TO YEAR END 1977 (\$10.767 BILLION TO \$13.857 BILLION). PUBLIC DEBT AND PUBLIC GUARANTEES OF PRIVATE DEBT INCREASED 34.1 PERCENT (\$6.061 BILLION TO \$8.127 BILLION). GOVERNMENT OF SPAIN DIRECT BORROWING INCREASED 62.1 PERCENT (\$1.771 BILLION TO \$2.871 BILLION) AND REPRESENTED 20.7 PERCENT OF TOTAL DEBT, AS OPPOSED TO 16.5 PERCENT IN 1976 AND 11.7 PERCENT IN 1975. UNGUARANTEED PRIVATE DEBT INCREASED 21.8 PERCENT (\$4.706 BILLION TO \$5.730 BILLION).

7. PROJECTIONS FOR 1978:

- FOR 1978 THE GOVERNMENT HAD EXPECTED NEW FOREIGN BORROWINGS OF APPROXIMATELY \$4.55 BILLION. OF THIS \$970 MILLION WAS TO BE DIRECT STATE DEBT. HOWEVER, WITH FOREIGN EXCHANGE RESERVES AT AN ALL TIME HIGH, IMPORTS SLACK DUE TO FLAT DOMESTIC DEMAND AND EXPORTS UP, THE GOVERNMENT'S NEED FOR NEW BORROWING HAS BEEN DRASTICALLY CUT BACK. AN INTER-MINISTERIAL COMMISSION DECIDED TO LIMIT NEW STATE BORROWING TO \$330 MILLION FOR THE YEAR. TOTAL NEW BORROWING WILL BE \$4.05 BILLION.

- ANOTHER FACTOR LIMITING THE NEED FOR NEW DEBT HAS

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BEEN THE PERSISTENCE OF EXCESS LIQUIDITY IN THE SPANISH MONEY MARKET. SLACK DOMESTIC DEMAND FOR NEW INVESTMENT FUNDS IS A PRINCIPAL CAUSE, ALONG WITH GREATLY INCREASED

FOREIGN EXCHANGE RESERVES. BECAUSE OF THIS EXCESS LIQUIDITY THE GOVERNMENT HAS MADE A SPECIFIC EFFORT TO SHIFT PUBLIC ENTERPRISE AND PRIVATE SECTOR BORROWING TO DOMESTIC SOURCES WHEREVER POSSIBLE. FOREIGN BORROWING BY PUBLIC AGENCIES WILL THUS BE REDUCED SOMEWHAT FROM ORIGINAL EXPECTATIONS. PRIVATE BORROWING WILL PROBABLY RISE A BIT OVER INITIAL FORECASTS, DESPITE SLACK DEMAND, AS COMPANIES MOVE TO TAKE ADVANTAGE OF GENERALLY LOWER EURODOLLAR RATES AND THE SLOW, BUT CONTINUING APPRECIATION OF THE PESETA. (SINCE THE 20 PERCENT DEVALUATION OF JULY 1977 THE PESETA HAS RISEN, AS OF EARLY JUNE, 8.93 PERCENT AGAINST THE DOLLAR AND 5.45 PERCENT AGAINST THE BASKET OF CURRENCIES TRADED IN MADRID).

- ALL TOLD, THE GOVERNMENT IS NOW EXPECTING FOREIGN DEBT TO TOTAL APPROXIMATELY \$15.3 BILLION AT YEAR END, DOWN FROM ITS ORIGINAL \$15.8 BILLION FORECAST.

8. THERE HAS BEEN CONSIDERABLE SPECULATION THAT THE GOVERNMENT WOULD TRY TO TAKE ADVANTAGE OF LOWER EURO-DOLLAR RATES, AND SPAIN'S EXTENSIVE LINES OF COMMERCIAL CREDIT, TO UTILIZE ARBITRAGE TO LOWER THE AVERAGE COST OF MONEY. A SUBSTANTIAL PORTION OF THE OLDER DEBT, CONTRACTED AT A TIME WHEN SPAIN WAS A MORE RISKY CREDIT, IS AT 1 AND 1/4 TO 1 AND 3/8 OVER LIBOR. MONEY IS NOW AVAILABLE TO THE GOVERNMENT AND GOVERNMENT BACKED BORROWERS AT APPROXIMATELY 3/4 PERCENT. WITH LOWER RATES AND PERHAPS LONGER GRACE PERIODS AND MATURITIES, SPAIN MIGHT BE ABLE TO BOTH STRETCH OUT, AND LOWER ITS PUBLIC DEBT SERVICING BURDEN. FOR THE PRESENT IT LOOKS AS IF THE GOVERNMENT WILL NOT DO THIS IN ANY SYSTEMATIC WAY. THE TREASURY SAYS IT WOULD NEED A NEW DECREE LAW AUTHORIZING PREPAYMENT OF EXISTING LOANS, AND THE GOVERNMENT

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APPEARS RELUCTANT TO PUSH FOR SUCH A LAW. CERTAINLY

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INFO AMEMBASSY PARIS

AMEMBASSY BRUSSELS

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USOECD; USEEC

PASS TREASURY, EXIM, COMMERCE, FRB

THE MAJOR FOREIGN BANKS WHO STOOD BY SPAIN WHEN TIMES WERE ROUGHER WOULD NOT APPRECIATE HAVING TO REFINANCE PROFITABLE LOANS AT A VERY SMALL MARGIN. ALSO, THERE MAY WELL BE POLITICAL SENSITIVITY TO CONTRACTING FOR SIGNIFICANT NEW LOANS IN A PRE-ELECTION PERIOD WHEN FOREIGN EXCHANGE RESERVES ARE ALREADY SO HIGH, EVEN THOUGH, OVER TIME, IT WOULD LEAD TO AN ACTUAL DECLINE IN SERVICING COSTS. NEXT YEAR'S BUDGET WILL CONTAIN A SECTION AUTHORIZING PREPAYMENT OF FOREIGN LOANS AND THE GOVERNMENT MAY THEN SEEK AN ARBITRAGE ADVANTAGE.

9. THE GOVERNMENT IS ACTIVELY TRYING TO SHIFT ITS OWN FOREIGN FINANCING FROM MEDIUM TERM COMMERCIAL SOURCES TO THE LONGER TERM EURODOLLAR, DM AND YEN MARKETS. THEY ARE PARTICULARLY INTERESTED IN THE U.S. CAPITAL MARKET AND FOR THE LAST SIX OR SEVEN MONTHS HAVE BEEN SEEKING UNCLASSIFIED

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A "TRIPLE A" RATING FROM MOODY'S AND STANDARD AND POORS. FIRST EFFORTS WERE NOT SUCCESSFUL, BUT DISCUSSIONS HAVE BEEN RENEWED RECENTLY. WHEN AND IF A "TRIPLE A" RATING IS OBTAINED, THE GOVERNMENT WILL TRY A SMALL ISSUE, PERHAPS \$25 MILLION TO TEST MARKET ACCEPTANCE.

- (MILLIONS OF DOLLARS)

- (YEAR END FIGURES)

-

- 1976

- LONG MEDIUM TOTAL

7 TOTAL 10,235 532 10,767

I. PUBLIC DEBT

- STATE	1,771	---	1,771
- RENFE	787	28	815
- INI (DIRECT)	522	---	522
- INI ENTERPRISES	1,378	151	1,529
- (WITH STATE GUARANTEE) (173)	---		(173)
- (WITH INI GUARANTEE) (376)	(6)		(382)
- (WITHOUT STATE GUAR.) (829)	(145)		(974)
- OTHER PUBLIC AGENCIES	496	---	496
- TOTAL PUBLIC DEBT	4,954	179	5,133

II. PRIVATE DEBT

- WITH PUBLIC GUARANTEE	928	---	928
- AUTOPISTAS	825	---	825
- OTHERS	103	---	103
- WITHOUT PUBLIC GUAR.	4,353	353	4,706

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- AUTOPISTAS	385	101	484
- OTHERS	3,970	252	4,222
- TOTAL PRIVATE DEBT	5,281	353	5,634

III. PUBLIC DEBT PLUS PUBLIC

- GUARANTEES	5,882	179	6,061
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SOURCES: BANK OF SPAIN, TREASURY, TRADE PUBLICATIONS

- (MILLIONS OF DOLLARS)

- (YEAR END FIGURES)

- 1977			
-	LONG	MEDIUM	TOTAL
- TOTAL	12,959	898	13,857

I. PUBLIC DEBT

- STATE	2,871	---	2,871
- RENFE	949	---	949
- INI (DIRECT)	529	---	529
- INI ENTERPRISES	1,902	242	2,144
- (WITH STATE GUARANTEE) (139)	---		(139)
- (WITH INI GUARANTEE) (541)	(2)		(543)
- (WITHOUT STATE GUAR.) (1,222)	(240)		(1,462)
- OTHER PUBLIC AGENCIES	539	---	539

- TOTAL PUBLIC DEBT 6,790 242 7,032

II. PRIVATE DEBT

- WITH PUBLIC GUARANTEE 1,095 --- 1,095

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PASS TREASURY, EXIM, COMMERCE, FRB

- AUTOPISTAS 1,007 --- 1,007

- OTHERS 88 --- 88

- WITHOUT PUBLIC GUAR. 5,704 656 5,730

- AUTOPISTAS 421 85 506

- OTHERS 4,653 571 5,224

- TOTAL PRIVATE DEBT 6,169 656 6,825

III. PUBLIC DEBT PLUS PUBLIC

- GUARANTEES 7,885 242 8,127

SOURCES: BANK OF SPAIN, TREASURY, TRADE PUBLICATIONS.

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